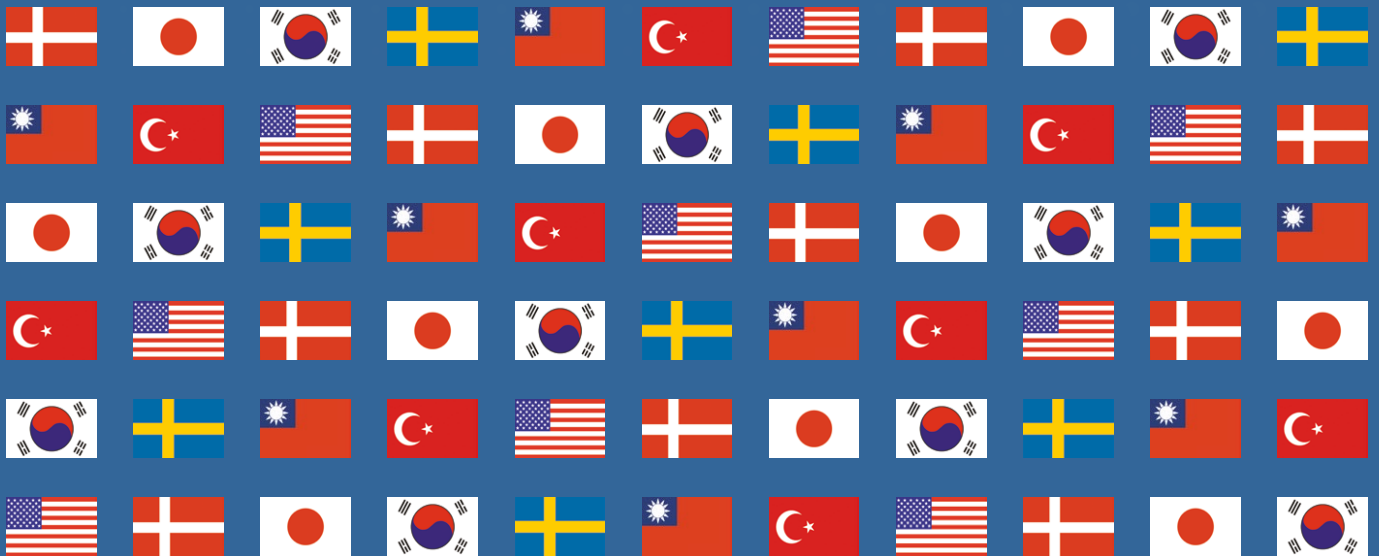


# VENTURE CAPITAL 2023

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Shin & Kim

**Sweden****52**

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Cirio Advokatbyrå AB

**Taiwan****69**

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Lee and Li Attorneys at Law

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**United States****102**

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[RETURN TO CONTENTS](#)

## Summary

<b>MARKET AND PURPOSE</b>	<b>91</b>
General role and purpose	91
Market conditions	91
<b>PARTIES AND DEAL STRUCTURES</b>	<b>92</b>
Issuers – typical profile	92
Issuers – domicile and company structures	92
Investors – typical profile	92
Investors – structures	92
Seed financings	93
Early-stage and later investments	93
<b>PROCESS</b>	<b>93</b>
Term sheets	93
Documentation	94
Key steps and timing	94
Closing conditions	94
Multiple closings	94
<b>DUE DILIGENCE</b>	<b>95</b>
Legal due diligence	95
Critical due diligence areas	95
Other due diligence	95
<b>ECONOMIC TERMS</b>	<b>95</b>
Valuation and pricing	95
Option pool	96
Dividends, distributions and redemptions	96
Company sales and liquidations	96
Anti-dilution protection	96
Future investments	96
Insider sales	97
<b>CONTROL RIGHTS</b>	<b>97</b>
Voting rights	97
Board rights	97
Board protections	97
Financial reports	98
<b>PUBLIC OFFERINGS AND LISTINGS</b>	<b>98</b>

[Read this article on Lexology](#)

Securities law requirements	98
Registration and listing rights	98
Other resale rights	98
<b>COMPANY SALES (M&amp;A)</b>	<b>99</b>
Standard sale structures	99
Role of investors	99
Post-closing protections	99
<b>LEGAL AND REGULATORY CONSIDERATIONS</b>	<b>99</b>
Disputes	99
Regulatory consents and filings	100
Foreign investment	100
<b>UPDATE AND TRENDS</b>	<b>101</b>
Key developments	101

## MARKET AND PURPOSE

### General role and purpose

#### 1 | How would you describe the role of venture capital in the financing markets in your jurisdiction?

Venture capital funds are among the most active investors in Turkey. Until recently, there were a relatively small number of domestic and foreign funds investing in Turkish start-ups and emerging companies. In keeping with the rise in the number of companies looking for funding opportunities, the number of regulated local venture capital funds has skyrocketed in the past several years. There has also been an increase in the number of asset management companies that manage these funds, as well as investment trusts, unregulated venture capital firms and foreign investors.

In addition to providing much-needed capital to startups and emerging companies, venture capital investors also help start-ups build better corporate governance practices, and provide long-term investment opportunities for individual and institutional technology investors.

### Market conditions

#### 2 | How would you describe the current market conditions for venture capital in your jurisdiction?

With the formation of tens of new regulated funds in the past few years, venture capital funds have begun to become an increasingly active investor type in the Turkish market. Turkish start-ups received approximately US\$1.7 billion of announced funding in 2022, compared with approximately US\$1.5 billion in 2021 and approximately US\$175 million in 2020. While these figures also include angel investors, a significant portion of the investments were made by venture capital investors.

In 2022, there were over 300 funding rounds, with over 300 local institutional investors and over 150 foreign institutional investors participating in these rounds.

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## PARTIES AND DEAL STRUCTURES

### Issuers – typical profile

- 3** | How would you describe the types of companies, and their different stages of development, that typically receive venture capital investment in your jurisdiction?

Investments tend to be concentrated in the seed and Series A stages, with a noticeable decrease in both local and international funding opportunities for companies in later stages. The market has a limited number of later-stage funds, and not many international venture capital firms invest in later stages.

### Issuers – domicile and company structures

- 4** | Are there any preferred or required legal domicile or company structures for issuers in venture capital transactions?

As a general principle, Turkish law does not restrict the ability of foreign companies to receive investments from Turkish investors. However, regulated funds have certain restrictions on their ability to invest in foreign-domiciled companies. That said, regulated funds can invest in foreign companies with at least 80 per cent of their assets in Turkey as if these companies were domiciled in Turkey. There are certain other rules governing regulated fund investments in foreign companies, and portfolios containing foreign-domiciled companies may be required to meet certain foreign or domestic ratio tests on an ongoing basis.

Investments by regulated Turkish funds and investment trusts into Turkish companies must be made into joint stock companies or limited companies provided these companies convert into joint stock companies within a year of the initial investment.

### Investors – typical profile

- 5** | How would you describe the types of investors that make venture capital investments, including by stage of company development, in your jurisdiction?

Angel investors tend to be more active in the seed stage, with funds, investment trusts and other institutional investors playing a more prominent role in later stages. That said, it is becoming increasingly common to see institutional investors in seed stages as the market is becoming more competitive.

### Investors – structures

- 6** | How are venture capital investors usually structured and does their structure affect their investment approach or terms?

The most active type of venture capital investors are local funds regulated by the Capital Markets Board (CMB). Other types of investors include investment trusts, also regulated by the CMB, foreign funds and local companies. Many of these funds, investment trusts and

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companies are corporate venture capital arms of conglomerates, other large enterprises and family offices.

Regulated local funds and investment trusts often tend to carry out full-scale due diligence on their target companies and use comprehensive deal documentation, while angel investors and foreign funds often rely on the due diligence conducted or to be conducted by these funds and investment trusts. Angel investors often execute shorter agreements and obtain fewer rights compared to funds and investment trusts.

Corporate venture capital firms tend to be more sector-specific than other venture capital investors, many of which are industry agnostic.

### Seed financings

#### 7 | What structures and types of investments are typically used for seed-stage investments in your jurisdiction?

Straight equity investments tend to be the norm. The market is trying to develop methods to use convertible and hybrid instruments but these are still rare, in large part owing to regulatory restrictions.

Investments are virtually always structured as new share issuances by way of a capital increase by the target company. Share acquisitions are almost never used.

### Early-stage and later investments

#### 8 | What structures and types of investments are typically used for early-stage and later investments, following seed-stage investments, in your jurisdiction?

Like seed-stage investments, straight equity investments tend to be the norm in later stages too.

Again, like seed-stage investments, investments are almost always structured as new share issuances by way of a capital increase by the target company, and share acquisitions are rarely undertaken.

## PROCESS

### Term sheets

#### 9 | Do parties normally use term sheets? If so, what is normally covered in such term sheets?

Most investors use term sheets. While some term sheets are very short and cover only the basic terms of the contemplated investment, many investors include most key terms in their term sheets in an effort to discuss and agree on these before expending further resources on due diligence and the drafting of the deal documentation. Filtering target companies by

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the way they approach term sheets and term sheets negotiations is often an effective and efficient strategy for institutional investors.

## Documentation

### 10 | What are the standard documents for a venture capital transaction, and who prepares them? Are there popular forms for such documentation in your jurisdiction?

The two primary agreements are the investment (share subscription) agreement and the shareholders' agreement. Investors' counsel will normally prepare these agreements, although in many early-stage angel rounds, company counsel prepares the documentation. The investment agreement and the shareholders' agreement are often combined into a single document (subscription and shareholders' agreement).

Closing documents (eg, general assembly documents, amendments to the articles of association of the company, board resolutions and signature authorities) are normally prepared by the target company's counsel and reviewed by the investors' counsel, although in certain transactions, especially if the target company does not have an experienced counsel to rely on, investors' counsel may also prepare the initial drafts of these documents.

## Key steps and timing

### 11 | What is the normal process and timing of venture capital investments in your jurisdiction?

The process usually follows a regular M&A transaction but is usually shorter, with two to three months being the norm. That said, many investments take much shorter and many much longer. Longer processes usually involve protracted negotiations over valuation and minority rights. The parties may delay the process for a few months to observe the financial performance of the company during this time frame as well as the founders' corporate governance practices.

## Closing conditions

### 12 | What closing conditions are common in venture capital transactions?

Many investors include the key findings of their due diligence exercise as conditions precedent in the deal documentation. Most typically, these conditions relate to the proper assignment of intellectual property rights to the company, and employee matters such as incomplete employment agreements.

## Multiple closings

### 13 | Are venture capital transactions ever divided into multiple closings? If so, how and why?

Multiple closings are rare. The issuance of new shares in a Turkish company normally requires the convening of a general assembly meeting, which is a time-consuming and

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arduous process. Accordingly, rolling or multiple closings are usually impractical and rarely used.

## DUE DILIGENCE

### Legal due diligence

- 14** | What legal due diligence is typically undertaken for venture capital transactions, and what specialists are typically involved?

Many regulated local funds and investment trusts tend to carry out full-scale legal due diligence, with a particular emphasis on intellectual property rights, employment law and data privacy. That said, some investors feel comfortable conducting limited or no due diligence, especially when investing in very early-stage companies.

### Critical due diligence areas

- 15** | What are normally critical areas of due diligence focus or red flags in venture capital transactions?

Critical findings usually relate to missing licences, intellectual property rights developed for but not properly assigned to the company, lack of proper documentation for employees and consultants, and shortcomings in compliance with data privacy legislation. Findings are usually included in the deal documentation as conditions precedent or subsequent.

### Other due diligence

- 16** | What other types of due diligence are commonly undertaken in venture capital transactions?

Investors almost always undertake some form of financial and tax due diligence. Many larger investors also undertake technical due diligence.

## ECONOMIC TERMS

### Valuation and pricing

- 17** | How is the company valuation and investors' purchase price usually determined in venture capital transactions?

Market comparables and conditions, as well as any recent funding rounds, usually guide the investors in determining the target company's valuation. There is often some negotiation on the valuation between the investors and the founders.

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## Option pool

### 18 | What do investors typically require for option pools or equity incentive arrangements in connection with venture capital transactions?

Investors normally require that 10 per cent of the company's share capital be set aside for employee option pools or other equity incentive arrangements. Investors also normally require that these shares be allocated from the shares held by the founders (and sometimes existing investors too).

## Dividends, distributions and redemptions

### 19 | What are the normal provisions governing dividends, distributions, redemptions or other profit distributions in venture capital transactions? Are there any legal limits thereon in your jurisdiction?

There are certain statutory requirements to be met for a company to be able to distribute dividends. Investors will normally obtain veto or consultation rights in connection with any such distributions, sometimes subject to certain conditions or thresholds.

## Company sales and liquidations

### 20 | How are venture capital investments treated in portfolio company sales or liquidations?

Investors will normally have liquidation preferences in company sales and liquidations. Preference multiples range between one to three times the investment amount, and the preferences tend to be non-participating.

## Anti-dilution protection

### 21 | What anti-dilution protections are typically built into the terms of venture capital securities?

Investors will typically have anti-dilution rights. These rights tend to apply to down rounds and are often capped. The anti-dilution shares may be transferred by the founders at no or nominal cost, or be subscribed to by the investor in the relevant round at nominal value. Sometimes the investor will have a choice as to which method to use, or the shareholders' agreement may prescribe the use of only one of these methods.

## Future investments

### 22 | What pre-emptive or pro rata investment rights do venture capital investors usually receive?

Turkish law accords statutory pre-emptive rights to all existing shareholders of the company. That said, the general assembly of shareholders may be able to limit these rights under certain circumstances. Accordingly, investors usually include pre-emptive rights in the investment documentation too.

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Many investors also include further investment rights in the investment documentation, sometimes at a discount.

### Insider sales

#### 23 | What rights do venture capital investors normally have over insider sales of securities of portfolio companies?

Venture capital investors often have rights of first refusal and tag along rights in connection with the sales of shares by the founders and other shareholders.

## CONTROL RIGHTS

### Voting rights

#### 24 | What voting rights, including veto or consent rights, do venture capital investors normally have as shareholders of their portfolio companies? Do they typically have special voting or consent rights as shareholders?

Investors often have wide veto rights over decisions by the board of directors and the general assembly of shareholders. These rights usually relate to significant transactions, operational matters, and changes in the company's shareholding or capital structure.

### Board rights

#### 25 | What rights to representation on the board of directors or at meetings of the board of directors of portfolio companies do venture capital investors typically receive?

Many investors obtain board seats in their portfolio companies. That said, some investors choose to have observer status only. When that is the case, the investor will normally have certain consultation or prior consent rights.

### Board protections

#### 26 | What fiduciary duties and liability protections normally apply to investor directors in your jurisdiction? Do directors typically have special voting or consent rights?

Turkish law does not distinguish between investor directors and other directors in the fulfilment of statutory duties as a director. That said, a director with an executive role may be exposed to higher potential liability by virtue of their duties. There are no casting votes in Turkish company boards, but it is possible to formulate the meeting and decision quorums such that investor directors have an effective veto over defined matters.

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## Financial reports

### 27 | What rights to financial reporting or company access do venture capital investors normally receive?

Investors normally have broad information rights relating to the finances and operations of the company. These rights often also include direct access to employees, and books and records of the company. Investors may also have the right to conduct an independent audit of the company or require the company to appoint an independent auditor.

## PUBLIC OFFERINGS AND LISTINGS

### Securities law requirements

### 28 | What are the securities law requirements in your jurisdiction for venture capital investors to sell their securities in the public markets?

Normally, the company must conduct an initial public offering (IPO) of its shares for venture capital investors to be able to sell their shares in the public markets. There is pending legislation for a Capital Markets Board-regulated pre-IPO market to be created, but the draft legislation contemplates a strict ban on the ability of existing shareholders to be able to sell their shares and instead contemplates the issuance of new shares.

### Registration and listing rights

### 29 | What registration rights, listing rights or other rights do venture capital investors normally receive?

Venture capital investors often have priority rights in an IPO of the company's shares as well as a right to veto any planned IPOs. Some investors will also include the right to demand an IPO in the shareholders' agreement.

### Other resale rights

### 30 | What other resale rights in the public markets do venture capital investors usually receive?

Venture capital investors sometimes have priority rights in secondary public offerings of the company's shares in instances where they sell less than all of their shares in the company's initial public offering of its shares.

## COMPANY SALES (M&A)

### Standard sale structures

- 31** | What are the standard structures or methods for venture capital portfolio companies to be sold in your jurisdiction?

The most typical exit route is the sale of the company, with initial public offerings being a rarity owing in large part to the rather strict listing requirements, such as profits in prior years, and the lack of a dedicated submarket with more lenient conditions for technology companies.

### Role of investors

- 32** | What is the role of venture capital investors in a portfolio company sale? Do they have rights to force or block a company sale?

Investors often have veto rights over the sale of the company. Investors also often have drag-along rights and sometimes the right to demand an initial public offering of the company's shares. These rights may be subject to certain time and valuation thresholds or may require the consent of a certain percentage of other shareholders or founders.

### Post-closing protections

- 33** | What post-closing matters or protections do venture capital investors typically obtain, for example to address ongoing company sale indemnities or director tail liabilities?

Transaction documents typically include customary indemnity undertakings by the founders relating to their warranties regarding the company's operations. Founders are usually also subject to broad non-compete obligations.

Transaction documents also often include post-closing covenants, which normally relate to corporate governance matters and deficiencies identified in legal and other due diligence exercises undertaken by the investor.

## LEGAL AND REGULATORY CONSIDERATIONS

### Disputes

- 34** | What types of disputes typically arise in venture capital transactions and how are disputes commonly handled? What provisions normally govern disputes, including choice of governing law, choice of forum and alternative dispute resolution mechanisms?

In investments into companies domiciled in Turkey, Turkish law is almost without exception the governing law of choice. In investments into companies domiciled elsewhere, the home country's law will normally govern the investment documentation.

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Dispute resolution is usually subject to arbitration, most typically in accordance with the rules of the Istanbul Arbitration Centre.

Disputes are relatively rare thus far in the market. When they do occur, they usually relate to the proper governance of the company, as well as disagreements over valuation and the rights of existing versus the new investors.

## Regulatory consents and filings

### 35 | What regulatory consents, notifications and filings are required for all investors in venture capital transactions in your jurisdiction? Are there ownership restrictions?

Investments involving the issuance of new shares (which is the norm, as share acquisitions by venture capital investors are virtually non-existent) requires the existing shareholders to convene a general assembly meeting to resolve on a capital increase. This capital increase must then be registered with the trade registry. If the company's articles of association are amended, as is usually the case to document certain investor rights such as veto rights, or new directors are appointed as part of the investment, these actions also require registration with the trade registry. Otherwise, normally, no regulatory consent, notifications or filings are required for investors in venture capital transactions, unless the company operates in a regulated industry requiring certain consent or filings.

Most target companies in venture capital transactions will not meet the regular merger clearance thresholds. That said, Turkey recently introduced amendments to its merger clearance rules to catch 'killer acquisitions' in the technology sector. The new rules disregard certain thresholds if a company engaged in the development of certain technologies is involved in the transaction. While venture capital investors typically do not purchase a majority of shares of their portfolio companies, veto rights could be regarded as affording negative control rights to the investor, thereby triggering merger clearance rules. That said, the market has shied away from filing for merger clearance, presumably based on the theory that a venture capital investment is arguably the antithesis of a killer acquisition as venture capital strives to make its portfolio companies grow with a view towards an exit.

## Foreign investment

### 36 | What foreign investment restrictions and other domestic regulatory issues arise for venture capital investors based outside your jurisdiction?

Foreign investors are treated the same as local investors with limited exceptions for regulated industries. The only typical regulatory hurdle for a foreign investor is the requirement to obtain a potential tax identification number, which is an easy process. A foreign investor does not become a Turkish taxpayer solely by virtue of obtaining this number, which is used for identification and potential withholding tax purposes.

## UPDATE AND TRENDS

### Key developments

- 37** | What are the most noteworthy current trends and recent developments in venture capital transactions in your jurisdiction? What developments are expected in the coming year?

As part of the response to the devastating earthquakes of February 2023, the Turkish parliament passed a new law imposing certain new taxes on companies. One of these taxes is a 10 per cent tax on all emission premiums (ie, consideration paid for newly issued shares exceeding the nominal value of these shares) injected into companies in 2022. The market has responded negatively to this tax for two reasons. First, this is a retroactive tax, which is arguably unconstitutional. Second, it essentially taxes a company's capital, which should not be, and had never before been, considered taxable income. In response to this retroactive tax, many start-ups are considering moving their headquarters to a different jurisdiction lest there be similar taxes in the future, and there are concerns in the market that foreign investors will lose at least some appetite.

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